# Private Banks and Companies on Bank Lending in Bulgaria *

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## Summary

Bank credit to the private sector has been growing continuously in Bulgaria since the introduction of the currency board arrangements in 1997. The upward trend was particularly strong in 2002 and 2003 but, as a share of GDP, bank credit still lags behind the ratio in other transition economies. The challenges in lending to the private sector, as repeatedly discussed in the documents of the European Commission, led to a survey being carried out among private companies and banks, which was sponsored by the European Institute and Capital Weekly. The survey was intended to identify the trends and issues in bank lending in Bulgaria by tracking changes in the supply of and demand for bank loans, as well as banks' lending policies.

In 2002, the significant growth in bank credit to private companies increasingly helped private sector development but it was still insufficient. Private companies stated that restricted access to borrowing was the third most important obstacle to their development. From the demand-side perspective, the survey among private companies revealed that, in 2002, more than one-third of the respondent companies did not apply for a bank loan for a number of reasons, including the fear that no bank would lend to them. Instead, they mostly relied on loans from friends, relatives or partners, the latter being a source mainly for big companies.

In 2002 and 2003, both the supply of and demand for bank credit increased. One can certainly expect continued demand for bank loans in future. The opportunities for borrowing will depend on the ability of companies to prepare creditworthy projects, to improve their financial performance, and to provide adequate collateral. Banks intend to continue increasing their lending to the private sector, especially to small businesses. At the same time, more than 46% of banks indicate that the shortage of long-term Lev-denominated deposits would constrain the future increase in local currency lending.

Both banks and companies are certain that banks have not reduced the risk premium on credit. In the context of banks' credit expansion, they have not reduced their risk aversion and they have substantially improved their risk assessment capabilities.

## Introduction

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Bank lending to the private sector has been on the increase in Bulgaria since the introduction of the currency board arrangement (CBA) in 1997. In 2002, it grew by 42 % compared with 2001 but could not make up for Bulgaria's lagging behind in terms of private sector credit-to-GDP ratio. The European Commission Strategy Paper and Regular Report on Bulgaria's Progress in 2002 noted that while in 2001 the average credit to the private sector was still low in the transition countries (about 27 % of GDP), against this background the private sector credit-to-GDP ratio in Bulgaria was "very weak", i.e. slightly over 14 % of GDP. The European Commission pointed out that, notwithstanding the sustainable growth in bank lending to the private sector in Bulgaria, it still remained limited and did not contribute sufficiently to the development of the private sector. At the same time, private businesses continued to rely on various alternative forms of borrowing, which operate on principles quite different from those of bank lending which is strictly regulated.

The issues of lending to the private sector, repeatedly discussed in European Commission documents, encouraged the European Institute and Capital Weekly to sponsor a survey among private companies and banks in early 2003. The aim of the survey was to identify the issues and trends in bank lending in Bulgaria by tracking changes in the supply of and demand and for bank loans from the perspective of both private creditors and private borrowers. Unlike the BNB surveys, conducted only among private banks, the European Institute survey was conducted both among private banks and VAT-registered companies and covered a period of one year. The credit portfolio of the banks included in the sample accounted for some 70 % of the total credit portfolio of the banking system in Bulgaria. A random sample was selected from among all VAT-registered companies in Bulgaria, resulting in 200 companies[1] which had taken out bank loans and another 200 which had not borrowed from banks over the period from 2000 to 2002.

The paper presents the results of the survey covering the year 2002 which was conducted by the European Institute and Alpha Research. It starts by analysing the dynamics of the main credit and deposit indicators, then the paper presents the survey results in the following sequence: demand for bank credit and alternative forms of lending, dynamics of demand for and supply of bank credit in 2002, factors influencing demand for and supply of bank credit and banks' lending policies. We end with conclusions and some policy recommendations on bank lending and banking sector stability.

## Bank Credit and Banks' Deposit Base

At the end of 2002, bank credit to the private sector as a percentage of GDP increased by over four percentage points but continued to lag behind the same indicator for the pre-crisis year of 1995, despite the substantial increase in the share of the private sector in the wake of the 1996-1997 financial crisis (Table 1). The volume of lending to the private sector and its share of GDP accordingly depended on the size of the deposit base as a major component of banks' lending capacity, on banks' lending policies, and on the demand for loans by the private sector. The period after

[1] A random sample of 1000 companies was selected from among all VAT-registered companies in Bulgaria. The ratio between those who had taken out bank loans and those who had not borrowed turned out to be 1:99. The sample was reinforced with another 100 borrower - companies selected at random in order to ensure adequate representation of the borrowers who were familiar with the process and had a clear understanding of the lending system. The final sample consisted of 200 companies which had taken out bank loans and another 200 companies which had not borrowed from banks.

the 1996-1997 crisis and introduction of the currency board was characterized by the gradual, but sustainable and irreversible recovery of banks' deposits (Table 1). In spite of the positive results attained in the sustainable and irreversible recovery of the deposit base, the available data proved that it accounted for just 32.8 % of GDP in 2002, i.e. it remained much lower than the deposit base in the pre-crisis year, 1995 (51.1%). Furthermore, at the end of 2002 the monetary aggregate M3/GDP ratio was 43.6 % and almost reached the 1996 ratio (44.4%) but still lagged behind the ratio 56.9 %, typical of the pre-crisis year of 1995. The reasons for the substantial lag in the deposits-to-GDP ratio at the end of 2002 in the context of the almost-recovered M3-to-GDP ratio could be found in the preservation of a relatively high share of money outside banks. At the end of 2002, the ratio of money outside banks to total deposits remained three times higher than that in the height of the crisis at the end of 1996 and at the end of the pre-crisis year of 1995.

**Table 1. Deposit and Credit Indicators**

| | 1995 | 1996 | 1997 | 1998 | 1999 | 2000 | 2001 | 2002 |
|---|---|---|---|---|---|---|---|---|
| ***Deposits/GDP, %*** | 51.1 | 40.0 | 21.1 | 21.6 | 22.4 | 25.6 | 31.9 | 32.3 |
| ***Domestic Credit/GDP, %*** | 67.4 | 61.5 | 28.8 | 20.7 | 19.0 | 17.4 | 20.9 | 23.7 |
| ***Private Sector Credit*/GDP, %*** | 21.6 | 37.0 | 11.0 | 11.6 | 13.9 | 13.9 | 14.1 | 18.4 |

***Source**: Bulgarian National Bank, Monetary Survey*

** Credit to the private sector includes loans to non-financial private enterprises and households. Most loans taken out by households are actually used for the needs of small businesses.*

The slowly recovering deposit base as a major element of banks' lending capacity could not be viewed as an impediment to lending until the end of 2001 because, at that time, most of the banks' available capacity was not used for lending purposes as banks pursued a policy of investing a substantial amount of their resources in low-risk foreign assets. In 2002, after the decline of interest rates abroad, banks reduced their holdings of foreign assets substantially and shifted their policies towards lending. Besides the deposit base and banks' lending policies, the demand for bank credit by private companies together with their abilities to meet banks' lending requirements, is another factor influencing the size of private sector credit.

**Demand for Bank Credit and Alternative Forms of Lending**

The survey among private businesses on the demand for loans revealed that in 2002 some 35 % of the respondents included in the sample did not apply for a loan at all. For the last three years, just under 29 % of companies have not applied for bank loans. Almost none of these were medium-sized or large enterprises. Most of the companies who have not applied for a bank loan over the last three years are small businesses (34 % of respondents). The same trend persisted in 2002: small businesses (approximately 42 %) accounted for the largest share of companies which had not applied for a bank loan while medium-sized and large enterprises (about 6 %) accounted for the lowest share.

Notwithstanding the considerable expansion of bank lending to the private sector in 2002, companies still perceive access to bank lending to be rather difficult, which, in their opinion, impedes their growth. The survey among private banks and companies on lending to the private sector, which was conducted by the *European Institute, Alpha Research and Capital Weekly* at the beginning of 2003, revealed that companies identified the difficult access to credit as the third most important obstacle to their development. The largest number of businesses pointed out the high taxes and the arbitrary and all-too-frequent legislative changes as the most serious impediments to their development. The next most important obstacles to the development of business and the private sector were the difficult access to credit, the complicated and burdensome licensing procedures and the environment of corruption in the economy. The difficult access to credit was the most serious problem for agricultural producers but large and medium-sized companies[2] did not find it so important.

**Table 2. Did you have to pay a bribe in order to take out a loan in 2002?**

| | Small Businesses | Medium-sized and Large Companies | Agricultural Producers | All Companies |
|---|---|---|---|---|
| ***Never, %*** | 88.0 | 100.0 | 92.3 | 90.6 |
| ***Once, %*** | 4.5 | 0.0 | 0.0 | 3.1 |
| ***2-3times, %*** | 3.0 | 0.0 | 0.0 | 2.1 |
| ***Over 3 times, %*** | 0.0 | 0.0 | 7.7 | 1.1 |
| ***No answer, %*** | 4.5 | 0.0 | 0.0 | 3.1 |

Corruption in the banking sector in the form of paying graft money when applying for a bank loan was quite limited and should not be considered a major obstacle to access to loans, except for the cases of lending to small businesses and agricultural producers. The payment of bribes when borrowing was not observed among large companies but it was widespread among small businesses and agricultural producers (Table 2.). Some 7.5% of the responding small businesses reported a one-off or repeated payments of bribes. Almost 8 % of the agricultural producers were asked for such money more than once in 2002.

**Table 3. Why didn't you apply for a bank loan in 2002?**

| | Small Businesses | Medium-sized & Large Enterprises | Agricultural Producers | All Companies |
|---|---|---|---|---|
| ***We did not need a bank loan, %*** | 47.0 | 0.0 | 66.7 | 47.0 |
| ***No bank would lend to us, %*** | 10.6 | 100 | 0.0 | 11.4 |
| ***We prefer alternative forms of credit, %*** | 18.2 | 0.0 | 0.0 | 17.2 |
| ***Other reasons, %*** | 15.2 | 0.0 | 0.0 | 14.3 |
| ***No answer, %*** | 9.0 | 0.0 | 33.3 | 10.1 |

The companies that have never applied for a bank loan usually state that they either do not need a loan or are aware of their non-eligibility as borrowers and therefore they seek alternative sources of lending among relatives, friends and business partners

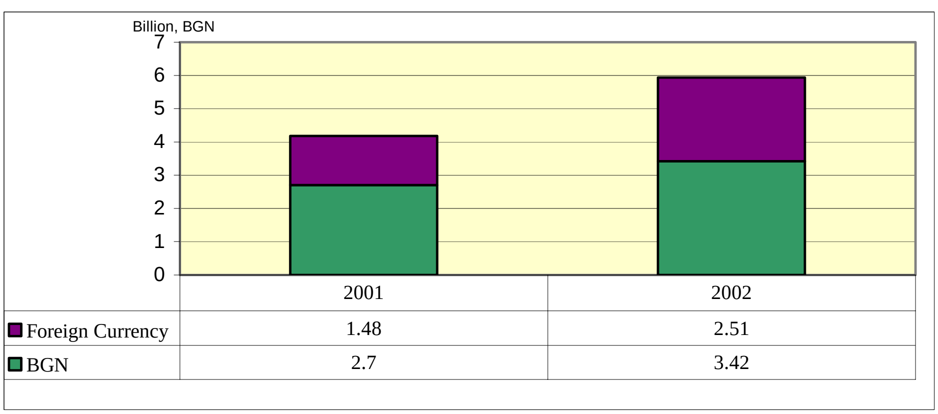
[2] For the purposes of the survey, companies whose turnover was less than BGN 5 million were considered to be small enterprises in accordance with the criterion applied by one large bank. The companies with an annual turnover exceeding BGN 5 million were viewed as medium-sized and large companies. Companies with an annual turnover of less than BGN 5 million accounted for 85 % of the sample, enterprises with a turnover of more than BGN 5 million made up 11 %, while those who gave no answer accounted for 4 per cent. Agricultural producers accounted for 10 % and the remaining 90 % were companies with other objects of activity.

(Table 3). The businesses that did not apply for a bank loan in 2002 typically depended on borrowing from friends and relatives (44.3%) or business partners (32.9%), the latter source being characteristic of large companies. All enterprises in the six per cent of the medium-sized and large companies who did not apply for a bank loan in 2002 indicated that they did not apply for a bank loan because they thought no bank would lend to them and hence they relied on borrowing from their business partners.
The greatest diversity of alternative forms of lending can be observed among small businesses. The largest proportion (45.5%) of small businesses that did not apply for a bank loan in 2002 relied on borrowing from friends and relatives. That was their main substitute for bank loans. One in three small companies that did not rely on bank loans borrowed from partners. A total of 79 % of small businesses and agricultural producers that did not apply for a bank loan in 2002 relied mainly on borrowing from friends and relatives*.*

**Dynamics of Demand for and Supply of Bank Credit in 2002**

In 2002, most banks and private borrowers shared the opinion that the volume and number of loans applied for and extended to borrowers increased. Banks observed an equal increase in the demand for and supply of both short- and long-term loans. Banks and companies tended to have somewhat different opinions on this. Unlike banks, the majority of companies stated firmly that 2002 saw an increase in the demand mainly for short-term loans. The percentage of companies which held this view was higher than that of companies which pointed out an increase in the demand for long-term loans. The opinion on the prevalence of the demand for short-term loans was maintained mainly by medium-sized and large companies, while agricultural producers emphasized their preference for long-term loans, denominated in domestic currency while at the same time almost 23 % of them firmly believed that approved long-term loans had decreased, regardless of the increased demand for them.

**Chart 1. Loans in Domestic and Foreign Currency, December 2002**




**Source:** BNB

Most respondent companies reported an increased demand for Lev-denominated loans rather than loans in foreign currency. Medium-sized and large companies were most unequivocal in their preference for Lev-denominated loans, followed by agricultural producers. In terms of demand for foreign currency loans in general, demand for Euro-denominated loans was highest.

The BNB data indicate that, notwithstanding the larger volume of BGN loans to the private sector, they grew by 26.8 % on a year-to-year basis at the end of 2002, whereas foreign currency-denominated loans increased by 69.8 per cent (Chart 1.). There was a discrepancy between the faster growth of foreign currency loans and the business preferences to borrow in Leva. One possible explanation could be the size and composition of the banks' deposit base which was dominated by long-term foreign currency deposits at the end of 2002. The maturity and currency composition of the banks' deposit base caused some concerns among banks with regard to their future lending capabilities. About 46.2 % of the responding banks were afraid that the shortage of long-term Lev-denominated deposits would restrict the growth of their Lev lending portfolio in future.

The growth in foreign currency lending could be a potential risk for banks because at the end of 2002 some 97 % of foreign currency-denominated loans (mainly in Euro) to the private sector were extended to corporate borrowers whose deposits were denominated mainly in BGN (about 63 %). Conversely, households saved mainly in foreign currency (primarily USD), while 95 % of the loans they took out were denominated in BGN. The same trends prevailed also in 2003. There might be a risk if corporate borrowers in foreign currency with revenues and deposits mainly in BGN faced difficulties in the regular servicing of their foreign currency loans.

**Table 4. Prudential Regulations: Selected Indicators**

| | 2000 | 2001 | 2002 |
|---|---|---|---|
| Non-performing loans, *% of total loans* | 8.2 | 7.0 | 5.5 |
| Loss, *% of total loans* | 3.4 | 2.7 | 1.8 |
| Provisions, *% of substandard loans* | 79.3 | 73.5 | 74.3 |
| Capital adequacy (Total) | 35.6 | 31.3 | 25.2 |
| Highly-liquid assets, *% of deposits* | | | |
| Primary | 10.4 | 13.5 | 11.2 |
| Secondary | 25.9 | 25.5 | 29.2 |

***Source**: BNB and IMF calculations*

At present, the BNB data on bad loans, provisioning and capital adequacy do not give any grounds for concern. Non-performing loans are on the decrease because of the increase in the proportion of new loans (Table 4). The provisioning covers only 74 % of substandard loans. Banks' capital adequacy and liquidity ratios remain high. In the context of the overall good indicators for the banking system as a whole, the banks from Group 4[*] tend to perform worse and they are subjected to more rigorous banking supervision.

The BNB response to the potential threat from credit and currency risks by introducing amendments to Regulation 9 was timely and adequate. They require classifying as "loss" any interest and principal arrears of over 120 days. Previously, Regulation 9 defined as "loss" only arrears of over 180 days.

[*] BNB groups Bulgarian banks in 5 groups according to their balance sheets. Group 4 includes 11 banks whose balance sheets exceed BGN 100 million.

## Factors Influencing the Supply of and Demand for Bank Loans

The increased demand for bank loans in 2002 was related to the substantial or moderate increase in the borrowing needs of companies. That opinion was shared by companies that had applied for a bank loan (67.7%) and companies in general, including non-borrowers (50%). Small companies and agricultural producers were the most ardent supporters of that opinion among borrowers (Table 5). Banks were also unconditional in their opinion that the companies' need for bank loans had increased moderately or substantially.

**Table 5. How did the borrowing needs of your company change in 2002?**

| | **Small Businesses** | | **Medium-sized & Large Enterprises** | | **Agricultural Producers** | | **All companies** | |
|---|---|---|---|---|---|---|---|---|
| | ***1*** | ***2*** | ***1*** | ***2*** | ***1*** | ***2*** | ***1*** | ***2*** |
| *Increased substantially, %* | 24.8 | 37.3 | 35.3 | 31.3 | 31.3 | 30.3 | 26.5 | 35.4 |
| *Increased moderately, %* | 22.6 | 32.8 | 23.5 | 25.0 | 31.3 | 38.5 | 23.5 | 32.3 |
| *Remained unchanged, %* | 26.3 | 19.4 | 29.4 | 31.3 | 31.3 | 30.8 | 27.1 | 22.9 |
| *Decreased moderately, %* | 6.8 | 4.5 | 5.9 | 6.3 | 0.0 | 0.0 | 6.0 | 4.2 |
| *Decreased substantially, %* | 6.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 4.9 | 0.0 |
| *Don't know, %* | 13.5 | 6.0 | 0.0 | 0.0 | 6.1 | 0.0 | 11.4 | 4.2 |
| *No answer, %* | 0.0 | 0.0 | 5.9 | 6.1 | 0.0 | 0.4 | 0.6 | 1.0 |

***1- All companies; 2-Companies which applied for a bank loan***

Most banks and companies stated that the major factors in the increased demand for bank loans were related to the growing corporate needs for working capital followed by the need for greater investment in machinery and equipment. That opinion was shared by the majority in all three groups of companies but it was most strongly held by agricultural producers. Banks considered the next important reason for the increased demand for bank loans to be the companies' shift from non-bank to bank borrowing linked in some cases to the growing inter-enterprise indebtedness, which began limiting companies' further reliance on borrowing from partners and friends. That is an alarming sign of growing inter-company indebtedness, which unequivocally calls for banks to pay more attention and lay down more stringent requirements regarding the financial condition of potential borrowers and transparency of their financial reports.

From the perspective of the banks' supply of loans, banks and companies that applied for bank loans in 2002 tend to agree that both the number and amount of approved loans increased, and the number of rejected loan applications fell accordingly. Some exceptions could be observed with regard to small businesses and agricultural producers: the former were of the opinion that there was an increase also in the number of refused short-term loans, while the latter report an increase in the number of refused long-term loans.

**Table 6. Reasons for Which Banks Reject Loan Applications**

| | | Small Businesses | Medium-sized & Large Enterprises | Agricultural Producers |
|---|---|---|---|---|
| **Non-viability of the project** | *No answer, %* | 0.0 | 7.7 | 7.7 |
| | *Of minor importance, %* | 0.0 | 0.0 | 7.7 |
| | *Fairly important, %* | 23.1 | 23.1 | 15.4 |
| | *Of decisive importance, %* | 76.9 | 69.2 | 69.2 |
| **Poor financial performance** | *No answer, %* | 0.0 | 7.7 | 7.7 |
| | *Of minor importance, %* | 0.0 | 0.0 | 7.7 |
| | *Fairly important, %* | 23.1 | 23.1 | 23.1 |
| | *Of decisive importance, %* | 76.9 | 69.2 | 61.5 |
| **Insufficient transparency of financial statements** | *No answer, %* | 0.0 | 7.7 | 7.7 |
| | *Of minor importance, %* | 7.7 | 7.7 | 15.4 |
| | *Fairly important, %* | 61.5 | 53.8 | 53.8 |
| | *Of decisive importance, %* | 30.8 | 30.8 | 23.1 |
| **Lack of, too short or unsatisfactory credit history** | *No answer, %* | 0.0 | 7.7 | 7.7 |
| | *Of minor importance, %* | 38.5 | 46.1 | 38.5 |
| | *Fairly important, %* | 38.5 | 38.5 | 23.0 |
| | *Of decisive importance, %* | 23.0 | 7.7 | 30.8 |
| **Lack of acceptable collateral** | *No answer, %* | 0.0 | 7.7 | 7.7 |
| | *Of minor importance, %* | 7.7 | 15.4 | 7.7 |
| | *Fairly important, %* | 53.8 | 46.1 | 53.8 |
| | *Of decisive importance, %* | 38.5 | 30.8 | 30.8 |
| **Unsatisfactory skills & qualifications of corporate management** | *No answer, %* | 0.0 | 7.7 | 7.7 |
| | *Of minor importance, %* | 30.8 | 30.8 | 30.8 |
| | *Fairly important, %* | 53.8 | 46.1 | 53.8 |
| | *Of decisive importance, %* | 15.4 | 15.4 | 7.7 |
| **Others** | *No answer, %* | 100 | 100 | 100 |

It is interesting to note that in some cases there are discrepancies between borrowers' and lenders' ranking of the significance of the reasons for rejecting loan applications. Bank respondents were of the definite opinion that the refusal to lend to businesses was most often associated with the non-viability of the projects, as well as with the poor financial performance of businesses (Table 6). Banks ranked the lack of acceptable collateral as the second most important reason to refrain from lending. Other reasons pointed out by banks as reasons of secondary importance concerning mainly small businesses and agricultural producers included the insufficient transparency of financial statements and the unsatisfactory skills and qualifications of companies' management. Unlike banks, companies identified the lack of acceptable collateral as the prime reasons for rejecting their applications. That opinion was shared mainly by small businesses followed by agricultural producers. The poor financial performance was quoted as the second major reason again mainly by small businesses and agricultural producers. None of the big companies cited poor financial performance as an obstacle to borrowing from banks.

The opinions of banks and businesses suggest that if small businesses and agricultural producers wish to stand a better chance of borrowing, they should propose viable projects, improve their financial performance and upgrade their managerial and financial skills, as well as broaden the scope of acceptable collateral.

**Banks' Lending Policies**

Despite the slow recovery of the banks' deposit base as a percentage of GDP, the substantial growth in lending to the private sector in 2002 was in fact largely linked to the change in banks' lending policies. The recent shift of a part of banks' foreign assets to domestic investment, including loans, has produced a positive impact on the increased lending to the real sector. The latter was linked to the reduction of interest rates on banks' foreign assets as a result of the global decline of interest rates. The 2002 BNB data point to a reduction in banks' foreign assets and an increase in their domestic assets, including loans, which suggests that the repatriation of foreign assets contributed to the increase in private sector credit.

The shift in the banks' policy to lending to the private sector was accompanied by some easing of their lending standards and terms. Most respondents who applied for loans in 2002 believed that banks had somewhat eased their standards for approval of bank loans (Table 7). That opinion was supported most firmly by medium-sized and large companies (50 %). Interestingly, however, most banks typically responded that they had somewhat eased their standards mainly for small businesses.

Banks and, to a less extent, companies pointed to some easing with regard to the size of loans, especially for small businesses. Most banks noted that the price of credit (interest plus charges and commission fees) had decreased somewhat. Most enterprises tended to believe that the price of credit remained unchanged and some reduction was observed only by large companies (Table 8). The reduced price of credit can be explained both by the global reduction in interest rates, and the increased competition among banks.

**Table 7. Changes in the Bank Standards for the Approval of Loan Applications**

| | **Small Businesses** | | **Medium-sized& and Large Enterprises** | | **Agricultural Producers** | | **All Companies** |
|---|---|---|---|---|---|---|---|
| | ***1.*** | ***2.*** | ***1.*** | ***2.*** | ***1.*** | ***2.*** | ***2.*** |
| *Became much tighter, %* | 7.7 | 19.4 | 7.7 | 6.3 | 7.7 | 7.7 | 15.6 |
| *Became somewhat tighter, %* | 7.7 | 16.4 | 7.7 | 0.0 | 15.3 | 23.1 | 14.6 |
| *Remained unchanged, %* | 15.3 | 28.4 | 30.7 | 43.7 | 38.5 | 30.7 | 31.3 |
| *Relaxed somewhat, %* | 38.5 | 31.3 | 23.1 | 50.0 | 7.7 | 38.5 | 35.4 |
| *Relaxed substantially, %* | 30.8 | 3.0 | 23.1 | 0.0 | 23.1 | 0.0 | 2.1 |

| | | | | | | | |
|---|---|---|---|---|---|---|---|
| *No answer, %* | 0.0 | 1.5 | 7.7 | 0.0 | 7.7 | 0.0 | 1.0 |

**1. Responses from banks; 2. Responses from companies**

Both banks and businesses noted that banks had not adjusted their risk premium on loans but they had improved their risk assessment skills (Table 8). Over 46 % of banks and almost 40 % of businesses thought that banks had improved their risk assessment skills. This leads us to conclude that a positive tendency emerged, in parallel with credit expansion, which allowed banks to preserve their risk aversion and to improve their skills in assessing risk more accurately.

**Table 8. Changes in the Banks' Policy concerning the Lending Parameters**

| | | **Small Businesses** | | **Medium-sized and Large Enterprises** | | **Agricultural Producers** | | **All Companies** |
|---|---|---|---|---|---|---|---|---|
| | | **1.** | **2.** | **1.** | **2.** | **1.** | **2.** | **2.** |
| **Maximum amount of the loan** | *No answer, %* | 0.0 | 7.5 | 7.7 | 12.5 | 7.7 | 23.1 | 10.4 |
| | *Became much tighter, %* | 0.0 | 10.4 | 0.0 | 6.3 | 0.0 | 7.7 | 9.4 |
| | *Became somewhat tighter, %* | 0.0 | 13.4 | 0.0 | 0.0 | 0.0 | 7.7 | 10.4 |
| | *Remained unchanged, %* | 15.4 | 32.8 | 23.0 | 50.0 | 30.8 | 23.1 | 34.4 |
| | *Relaxed somewhat, %* | 61.5 | 35.3 | 46.2 | 31.2 | 46.2 | 23.0 | 32.3 |
| | *Relaxed substantially, %* | 23.1 | 0.6 | 23.1 | 0.0 | 15.3 | 15.4 | 3.1 |
| **Loan term** | *No answer, %* | 0.0 | 9.0 | 7.7 | 12.5 | 7.7 | 23.1 | 11.5 |
| | *Became much tighter, %* | 0.0 | 10.4 | 0.0 | 6.2 | 0.0 | 0.0 | 8.3 |
| | *Became somewhat tighter, %* | 7.7 | 6.0 | 7.7 | 0.0 | 7.7 | 7.7 | 5.2 |
| | *Remained unchanged, %* | 30.8 | 44.8 | 38.5 | 43.8 | 38.5 | 30.8 | 42.7 |
| | *Relaxed somewhat, %* | 23.0 | 28.4 | 30.8 | 37.5 | 15.3 | 15.3 | 28.1 |
| | *Relaxed substantially, %* | 38.5 | 1.4 | 15.3 | 0.0 | 30.8 | 23.1 | 4.2 |
| **Loan price** | *No answer, %* | 0.0 | 7.5 | 7.7 | 12.5 | 7.7 | 15.4 | 9.4 |
| | *Became much tighter, %* | 0.0 | 7.5 | 0.0 | 6.3 | 0.0 | 0.0 | 6.3 |
| | *Became somewhat tighter, %* | 0.0 | 10.4 | 0.0 | 0.0 | 0.0 | 15.4 | 9.4 |
| | *Remained unchanged, %* | 15.4 | 47.8 | 15.4 | 31.2 | 30.8 | 30.8 | 42.7 |
| | *Relaxed somewhat, %* | 76.9 | 26.8 | 53.8 | 37.5 | 53.8 | 23.0 | 28.0 |
| | *Relaxed substantially, %* | 7.7 | 0.0 | 23.1 | 12.5 | 7.7 | 15.4 | 4.2 |
| **Risk premium** | *No answer, %* | 15.4 | 22.4 | 23.1 | 25.0 | 23.2 | 23.1 | 22.9 |
| | *Became much tighter, %* | 0.0 | 9.0 | 0.0 | 0.0 | 0.0 | 7.7 | 7.3 |
| | *Became somewhat tighter, %* | 23.1 | 10.4 | 23.1 | 0.0 | 15.4 | 15.4 | 9.4 |
| | *Remained unchanged, %* | 38.5 | 40.3 | 38.5 | 75.0 | 46.2 | 38.5 | 45.8 |
| | *Relaxed somewhat, %* | 23.0 | 17.9 | 15.3 | 0.0 | 15.4 | 15.3 | 14.6 |
| | *Relaxed substantially, %* | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| **Requirements to the amount of the collateral** | *No answer, %* | 0.0 | 6.0 | 7.7 | 12.5 | 7.6 | 15.4 | 8.3 |
| | *Became much tighter, %* | 0.0 | 13.4 | 0.0 | 6.3 | 0.0 | 7.7 | 11.5 |
| | *Became somewhat tighter, %* | 7.7 | 10.4 | 7.7 | 6.3 | 7.7 | 30.8 | 12.5 |
| | *Remained unchanged, %* | 38.5 | 53.8 | 38.5 | 50.0 | 46.2 | 30.8 | 50.0 |
| | *Relaxed somewhat, %* | 38.5 | 16.4 | 38.5 | 18.8 | 30.8 | 15.3 | 16.7 |
| | *Relaxed substantially, %* | 15.3 | 0.0 | 7.6 | 6.3 | 7.7 | 0.0 | 1.0 |
| **Requirements to collateral liquidity** | *No answer, %* | 0.0 | 13.4 | 7.7 | 12.5 | 7.7 | 23.0 | 14.6 |
| | *Became much tighter, %* | 0.0 | 9.0 | 0.0 | 6.3 | 0.0 | 0.0 | 7.3 |
| | *Became somewhat tighter, %* | 15.4 | 9.0 | 15.4 | 0.0 | 15.4 | 23.1 | 9.4 |
| | *Remained unchanged, %* | 84.6 | 53.7 | 76.9 | 68.8 | 76.9 | 38.5 | 54.2 |
| | *Relaxed somewhat, %* | 0.0 | 13.4 | 0.0 | 12.4 | 0.0 | 15.4 | 13.5 |
| | *Relaxed substantially, %* | 0.0 | 1.5 | 0.0 | 0.0 | 0.0 | 0.0 | 1.0 |
| **Others** | *No answer, %* | 92.3 | 86.6 | 92.3 | 81.3 | 92.3 | 100.0 | 87.5 |
| | *Became much tighter, %* | 0.0 | 1.4 | 0.0 | 0.0 | 0.0 | 0.0 | 1.0 |
| | *Became somewhat tighter, %* | 7.7 | 0.0 | 7.7 | 0.0 | 7.7 | 0.0 | 0.0 |
| | *Remained unchanged, %* | 0.0 | 9.0 | 0.0 | 12.5 | 0.0 | 0.0 | 8.3 |

| | | | | | | | |
|---|---|---|---|---|---|---|---|
| | *Relaxed somewhat, %* | 0.0 | 3.0 | 0.0 | 6.2 | 0.0 | 0.0 | 3.2 |

**1. Responses from banks; 2. Responses from companies**

Banks indicated the increased inter-bank competition, the improved risk assessment skills and the improved quality of their loan portfolios as the major factors promoting lending. The second and third most important factors were believed to be the favourable macroeconomic environment and climate in specific sectors, the reduced number of bankruptcies, the enhanced liquidity position and the improving deposit base. Most companies basically supported the prevailing opinion of banks. They agreed with banks that increased inter-bank competition was the major factor facilitating lending. The second important reason, in their opinion, was the reduced number of bankruptcies and the decrease in non-performing loans, as well as the improved ability of banks to assess risk.

Most banks explained the cases of tightened lending as being first and foremost due to the slow and imperfect bankruptcy proceedings. Other important reasons were the existence of administrative barriers to creditors' effective collection of claims, insufficient legal protection for creditors and the cumbersome legislation and procedures for the calling in of registered pledges.

Banks firmly believe that they will continue increasing lending in future. They are 100 % certain about their intentions to increase lending to small businesses. Some 85 % of banks stated that they would extend more loans to medium-sized and large companies. There is more limited support (53.8%) for growth in lending to agricultural producers, which suggests that agriculture will remain a bit of a problem sector from a bank lending perspective (Table 9).

**Table 9. Banks' Intentions to Lend to Private Companies in 2003**

| | Small Businesses | Medium-sized and Large Companies | Agricultural Producers |
|---|---|---|---|
| *Will increase, %* | 100.0 | 84.6 | 53.8 |
| *Will not change, %* | 0.0 | 7.7 | 23.1 |
| *Hard to say, %* | 0.0 | 0.0 | 15.4 |
| *No answer, %* | 0.0 | 7.7 | 7.7 |

## Conclusions

The survey on private sector credit in 2002, conducted at the beginning of 2003 among private banks and companies leads to the following conclusions:

- 2002 saw an increase in the supply of and demand for bank loans, as a result of which bank lending to the private sector increased substantially compared with 2001. Nevertheless, as a percentage of GDP it remained far below the average for the Central and Eastern European countries.
- Although banks increased their lending substantially in 2002, private companies and agricultural producers typically continued relying on alternative sources and forms of borrowing from partners, friends, relatives, etc. Those were mainly borrowers that were not eligible for bank borrowing and one can certainly claim that they borrowed from alternative sources under easier terms. The alternative forms of lending are not regulated and it is very difficult to obtain reliable information about them. One can only assume that their importance will decrease as companies become increasingly eligible for borrowing from banks.

- The findings of the survey lead to the conclusion that the demand for bank loans will continue to grow in future mainly due to the increased need of companies for working capital and equipment, as well as due to the shift from non-bank to bank lending. The latter is generally a positive development but it could also be a sign of the exhausted potential of inter-company lending (lending to partners) as a result of the growing inter-company indebtedness, including arrears. The cases of the shift by companies from non-bank to bank borrowing due to increased inter-company arrears generate some concerns as to whether there will ultimately be an increase in non-performing loans in the banking sector as well. The fact that banks have not become less risk-averse and have definitely improved their risk assessment skills is a rather positive signal. However, it is increasingly important for banks to pay greater attention to the financial condition of companies and the transparency of their financial statements, as well as to strengthen the BNB banking supervision standards. The amendments to BNB Regulation 9 give further grounds to believe that the growing lending activity of banks will not undermine their stability.
- The ability to meet the increased corporate demand for bank loans will depend on banks' availability of loanable funds and on the ability of companies to submit viable and bankable projects, to improve their financial performance and to provide appropriate collateral. As to future lending policy, banks intend to further increase their lending to the private sector, especially to small businesses. Banks tend to be most uncertain about their long-term Lev-denominated lending to agricultural producers. This might be due to the poor financial performance of agricultural producers and their inability to propose bankable projects, as well as due to some constraints related to the deposit base of banks. 46.2% of banks stated that the shortage of long-term Lev-denominated deposits could constrain Lev-denominated lending in future. The further recovery of the deposit base and the improvement of its structure will certainly produce a positive impact on the ability to meet the increased demand for Lev-denominated bank loans by the private sector.

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